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SUBJECT: SE TURKEY'S INITIAL REACTIONS TO
NEW ECONOMIC INCENTIVES' LAW

1. (SBU) President Ahmet Necdet Sezer approved an "economic incentives" law on January 29, 2004, which grants tax and insurance privileges, as well as energy support and free land, to regional investor in an effort to increase employment opportunities in eastern and southeastern Turkey.

2. (SBU) According to a statement released by the Presidential Press Office, the law has been printed in the Official Registry as of February 6, 2004. The Law grants these privileges to all cities with less than \$1,500 per capita annual income as of 2001. The free land provision includes all cities with less than \$1,500 per capita income and special economic development areas. Thirty-six cities are going to benefit from this law. Incentives in these cities include provisions that new employees and workers employed since October 2003 will pay only 20 percent of their required taxes. The Treasury will pay the insurance premiums of all new employees. For other regions, the Treasury will pay 80 percent of the insurance costs.

3. (SBU) Firms which employ at least 10 people in these 36 cities will be allocated free Treasury or state lands. In order to receive the free land, the firm has to employ the agreed number of employees for five years. Energy support for investors will be provided until 2008. The Treasury will pay 20 percent of the electricity costs of firms which employ at least 10 people and are in the mining production, greenhouse, animal, tourism, education or health sectors. Every additional employee above ten will increase the rate paid in the electrical subsidy by half a point. Public sector enterprises will benefit from energy support, but not insurance subsidies. Firms operating in free-trade areas will also receive tax and insurance incentives.

4. (SBU) Of 36 affected cities, 14 are in the Adana Consular District: Malatya, Diyarbakir, Osmaniye, Batman, Sanliurfa, Mardin, Adiyaman, Van, Bingol, Mus, Siirt, Bitlis, Hakkari and Sirnak. Conspicuous by its absence is the southeast province of Tunceli which Consulate Adana initially estimated would meet the low per capita income threshold for this initiative. However, upon consultation with Tunceli Chamber of Commerce and Industry General Secretary, Adana Consulate found out that reason why Tunceli was excluded from this list because its per capita annual income was \$1,584.

5. (SBU) Chamber of Commerce and Industry officials in southeast Turkey found the recently passed Economic Incentive Bill positive but inadequate. They said the majority of the western entrepreneurs who would like to benefit from these incentives would not go to their cities, but rather to

Duzce, which also receive regional subsidies, because of its proximity to their existing investment in Istanbul. If there had been a 100 percent investment and tax exemption in the region, then the businessmen said that they might attract either foreign direct investment or shifting domestic investment to the southeast Turkey region. They also said that the Incentive bill would have been more useful if it had offered some concessions on provincial and sectoral bases. Generally, they expect some small scale investments from businessmen already active in the southeast region.

6.(SBU) One notable new domestic investment possibility emerged in Sanliurfa province, Mr. Ismail Demirkol, Sanliurfa Chamber of the Commerce and Industry, President said that, after endorsement of the bill, he was called by unspecified businessmen in the Istanbul garment sector who said that they would like to do some research on starting new garment factories in Sanliurfa. Mr. Demirkol believes such factories would contribute to mitigating the significant unemployment problem in the region.

COMMENT: The IMF sought to eliminate these investment incentives as part of the broader tax reform effort, but accepted a compromise incentive package in the face of the Prime Minister's insistence. There is considerable skepticism among Fund and World Bank staff that these incentives will result in significant new investments in the poorer parts of Turkey, but senior government officials in Ankara are convinced they are essential to the region's development.
REID